discover that he has the right to file a complaint, (2) to determine what the appropriate procedure is for filing a complaint, and (3) to gather information necessary to make the minimum showing that a rate is unreasonable. Moreover, allowing a subscriber 120 days to file a complaint is not unduly harmful to an operator, particularly because it will be able to implement the new rates, subject to refunds.

The Coalition also recommends that the operator be required to give 30 days advance notice to subscribers and franchising authorities of any rate changes as a matter of consumer protection.[56] This notice requirement would be a minimum, and a franchising agreement might require greater advance notice. In addition, any such notice to subscribers should include notification that subscribers have the right to file a complaint with the FCC. The operator should also be required to notify subscribers of this right at the time of installation and through a billing insert at least once a year.[57] This notice requirement is very important, because Congress' decision to allow subscribers to protest non-basic rate increases offers little protection unless subscribers are aware of the right. Certainly, existing subscribers accustomed to

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[56] Longer notice periods are not unusual even in smaller communities, and are often required because operators bill in advance for services.

[57] Such notice requirement is comparable to those imposed upon regulated utilities and telephone companies. See, e.g., 47 C.F.R. § 61.58(a)(4).

having their rate complaints fall upon deaf ears should be alerted to these new rights.

The Coalition also suggests that the FCC adopt a simple complaint form that a subscriber could submit, and this would satisfy the minimum showing that rates are unreasonable. An allegation that the per-channel rate established by the average cost of service methodology was exceeded either for the non-basic service, or for basic service collectively, would satisfy the necessary minimum showing. Such forms could be available from the FCC or the local franchising authority. A subscriber should be able to file a complaint on its own, without requiring an opinion or concurrence from the franchising authority or anyone else. Such independent filing was contemplated by the Act.[58] Nor does the Act contemplate imposing a more stringent standard upon franchising authorities or complainants represented by legal counsel.

B. Negative Option Billing

Summary of Coalition's Position

The FCC tentatively concludes that the prohibition on negative options precludes the operator from billing a subscriber for any service or equipment not affirmatively requested, orally or in writing. The FCC asks for comments on what types of retiering programming modifications and system upgrades are permissible in light of this prohibition, and how it should apply

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[58] House Conference Report at 64, 1992 U.S.C.C.A.N. at 1246.

to the initial implementation of the Act's basic service rate structure.

Subscribers must receive notice of all changes in service and equipment offerings, regardless of whether the overall amount paid by the subscriber is changed. Any changes to existing service made by negative option, and not affirmatively requested by all subscribers receiving the altered or new service or equipment, should be irrefutably presumed not to be a new service but rather should be deemed to be part of the existing service for regulatory purposes.

Discussion

The Coalition agrees with the FCC's tentative conclusion that the subscriber must have, at some point prior to receiving a service, affirmatively requested the particular programming service or equipment. Inaction or silence does not constitute an affirmative request. A request may be made either orally or in writing, as the FCC suggests.

The Coalition also agrees that an operator may not charge or seek payment for any service or equipment provided in violation of the Act's negative option prohibition or the FCC's implementing rules.

The Coalition also asks the FCC to recognize that, even where tier changes may be revenue-neutral, at least initially, they nevertheless may violate the prohibition on negative options. In Gillette, Wyoming, for example, the operator automatically switched all subscribers from basic to expanded

basic service, requiring subscribers to notify the operator if they did not want to receive the "new" tier of service. While the expanded basic service (which included basic service) contained the identical programming and cost the same amount as the previous basic service, and thus was presumably revenue neutral, it nevertheless was a negative option, instituted to move subscribers from what TCI contended was a regulated tier to a deregulated tier, on which rates could rise rapidly. In such circumstances, where retiering actually disadvantages a subscriber, the company should be held to a strict market test if it wants to deregulate services by offering them as part of a separately marketed and priced tier (assuming it can in a particular case), then it must obtain the subscriber's permission in advance.

Subscribers must receive advance notice of all tiering changes, including any instance where an operator adds services or equipment and imposes a corresponding rate increase, and any instance where programming services or equipment are eliminated. Absent advance notice, implementing these alterations might otherwise constitute a negative option, and in any event, the changes might provide a basis for a complaint that the new rate is unreasonable in light of the change.

As Congress recognized, cable operators may attempt to retier services as a way to avoid or minimize the impact of rate regulation. CPCA § 623(b)(5)(C), 106 Stat. at 1467.[59] The

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[59] See also Senate Report at 75, 1992 U.S.C.C.A.N. at 1208.

manner in which a service is marketed and priced remain determinative factors in deciding what is included as part of a service, and whether that service is subject to regulation. Thus, for example, where a programming service previously included as part of basic service is moved to a different tier and is provided by negative option, that should be conclusive evidence that the retiered programming remains subject to regulation as basic service. For example, negative option retiering like that undertaken in Gillette, Wyoming should have no impact for purposes of rate regulation; the new "expanded basic" service would be regulable as basic service, even if the operator did not describe it as containing over-the-air broadcast signals. This approach gives effect to congressional intent to limit evasion of rate regulation through such practices as retiering, and negative option sales, and recognizes Congress' concern that operators may not simply elude the limitation on evasive practices by implementing changes prior to the effective date of the FCC's regulation.[60]

The Coalition also recommends that any cable operator that violates the prohibition on negative options should be subject to damages and other sanctions, including non-renewal of the franchise. State attorney generals should be deemed to have concurrent, but not superseding, authority to protect subscribers

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[60] Letter to Chairman Sikes, Att. 4. See also 138 Cong. Rec. S567 (daily ed. Jan. 29, 1992) (statement of Sen. Metzenbaum) (supporting measures that would limit the impact of retiering done in anticipation of rate regulation).

against negative option marketing. This is consistent with current authority of the state to protect consumers against unfair trade practices.

C. Collection of Information

Summary of Coalition's Position

The FCC already issued a questionnaire seeking rate regulation from cable operators. It proposes to collect that information annually. The FCC asks for comments generally on what other information might be appropriate, and whether it should be collected from every cable system, or just a sampling.

In addition to the information specified in Appendix C of the Notice of Proposed Rulemaking and in the FCC's Order, MM Docket No. 92-266, FCC 92-545, released December 23, 1992, the FCC should obtain information from operators regarding their costs of providing service. This cost information should be provided through a uniform system of accounts, as developed by the FCC, and would be similar to, but simpler than, the system required in the telephone industry. This information, including the cost information, must be submitted to franchising authorities at regular intervals.

D. Prevention of Evasions

Summary of Coalition's Position

The FCC proposes to allow parties to use expedited procedures to seek redress of rate regulation evasions. The FCC proposes to prohibit an "unjustified increase in rates" resulting from retiering, but believes that the Act requires restructuring of service offerings in some cases. The FCC asks what specific evasive activities should be prohibited, and how best to address retiering and repricing that occurred after the effective date of the Act but prior to implementation of FCC regulations.

The FCC must take a broad view of its obligation to prevent evasion of rate regulation. Any services or equipment moved from basic service to non-basic service since the date of enactment of the 1992 Act should be ignored, for purposes of determining whether and to what extent a tier is subject to regulation. Thus, where an operator removed some services from a basic service tier after October 5, 1992, the tier to which those services were removed should be regulable as basic service.

In addition to allowing rollbacks in general, the FCC should order rollbacks of rate increases that occurred after the effective date of the 1992 Cable Act.

In addition, the FCC should make clear that the following practices undercut effective rate regulation: (1) a decrease in programming services without a decrease in rates; (2) a decrease in the quality of customer services or signals without a decrease in rates; (3) omission of other revenues or improper

cost shifting between systems; and (4) retiering to avoid rate regulation.

Discussion

The Coalition agrees with the FCC's tentative conclusions that interested parties may take advantage of expedited procedures to redress evasive practices. The FCC should periodically review regulations intended to prevent evasive practices by operators.

The Coalition disagrees with the FCC's suggestions that the Act permits and perhaps requires cable operators to retier. Nothing in the Act requires or endorses retiering. See discussion above to the contrary. Retiering is disfavored where it is intended to minimize or has the effect of minimizing rate regulation. At most, the Act requires operators to add some television broadcast signals to satisfy the must-carry requirements and allows operators to move PEG channels to basic service tiers; as a practical matter, however, any PEG channels provided are already included as part of basic (rather than non-basic) service. Moreover, Congress did not intend to require operators to remove PEG services from non-basic tiers.[61]

Congress made clear that it did not intend to allow cable operators to evade rate regulation simply by retiering

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[61] H.R. Rep. No. 628, 102d Cong., 1st Sess. 85 (1992).

prior to the date of FCC regulations restricting such retiering.[62] The massive retiering done by cable operators after the Act was enacted should have no effect for purposes of regulation. In addition, the FCC should recognize and prohibit certain operator practices that are designed to limit the impact of rate regulation. For instance, misallocating or omitting revenues from regulable tiers, decreasing programming services or reducing customer service without decreasing rates are some of the ways that cable operators seek to increase profits at the expense of subscribers. The FCC should prohibit such evasive practices.

E. Grandfathering of Rate Agreements

Summary of Coalition's Position

The Act provides that the statute and implementing FCC regulations do not supersede franchising agreements made before July 1, 1990 that authorize regulation of basic rates where effective competition did not exist at that time. CPCA §623(j), 106 Stat. at 1470. The FCC asks how to treat this "grandfather" provision in light of the certification requirements and other basic rate regulation provisions. It also asks what transition is necessary in communities now regulating rates but not subject to the grandfather clause.

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[62] Letter to Chairman Sikes, Att. 4. See also 138 Cong. Rec. S567 (daily ed. Jan. 29, 1992) (statement of Sen. Metzenbaum) (supporting measures that would limit the impact of retiering done in anticipation of rate regulation).

There is no need for franchising authorities that fall within the grandfather provision to notify the FCC of their intent to regulate rates. In addition, communities that are now regulating basic rates but which do not fall within the grandfather provision have no need to file a certification form, but instead need only notify the FCC of their intent to continue regulating. Pre-July 1, 1990 agreements for rates, including agreements to provide certain services (or a level of service), remain enforceable in toto, notwithstanding any provisions of the Cable Act that appear to permit operators to retier or restructure services. Agreements for rates tied to specific services are enforceable even if entered into after July 1, 1990. It is an accepted tenet of rate regulation that two parties may enter into a rate agreement which will be enforceable unless the rate is so high or so low to be against the public interest.

Discussion

The Coalition agrees with the FCC's tentative conclusion that franchising authorities that entered into franchise agreements before July 1, 1990 and that were regulating rates at that time may continue to regulate without filing a certification with the FCC.

The Coalition disagrees with the FCC's tentative conclusion that franchising authorities that fall within the grandfather provision of the Act must nevertheless notify the FCC

of their intent to continue to regulate rates. No such action is necessary.

The Coalition also asks the FCC to recognize that the terms of rate agreements, whether entered into before or after July 1, 1990, are fully enforceable. See discussion supra. Franchising authorities that are now regulating rates but that are not subject to the grandfather provision may continue to regulate rates, without filing certification, but must notify the FCC of their intent to continue to regulate. This will avoid a potential gap between the date the old provisions of the Cable Act expires the date the new ones go into effect. Since systems already regulating rates clearly meet the effective competition test and are already regulating subject to FCC rules, certification delay is unnecessary and would be unfortunate.

F. Subscriber Bill Itemization

Summary of Coalition's Position

The Act permits cable operators to itemize amounts attributable to franchise fees, PEG requirements and governmental assessments on transactions between the operator and the subscriber. The FCC tentatively concludes that only direct and verifiable costs may be itemized. It also suggests that the costs may not be separately billed.

Only direct and verifiable costs may be itemized and they may not be sent forth in a manner that makes it appear that the charges represent separately billed service. Moreover, the regulations should prohibit any misleading statements on bills.

Discussion

The Coalition agrees with the FCC's tentative conclusions that only direct and verifiable costs may be itemized. Such itemized amounts may not be separately billed.[63]

Respectfully submitted,

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Dated: January 27, 1993

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[63] H.R. Rep. No. 628, 102d Cong., 1st Sess. 86 (1992).

[redacted]

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
Rate Regulation	)	

COMMENTS OF AUSTIN, TEXAS; DAYTON, OHIO; DUBUQUE, IOWA; GILLETTE, WYOMING; MONTGOMERY COUNTY, MARYLAND; ST. LOUIS, MISSOURI; AND WADSWORTH, OHIO

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January 27, 1993

REPORT TO THE FEDERAL COMMUNICATIONS COMMISSION IN RESPONSE TO NOTICE OF PROPOSED RULEMAKING TO IMPLEMENT RATE REGULATION SECTIONS OF THE CABLE TELEVISION CONSUMER PROTECTION AND COMPETITION ACT OF 1992

(FCC 92-544; MM Docket 92-266)

January 27, 1993

ANALYSIS OF CABLE TELEVISION RATE MODELS AND PROPOSAL FOR DEVELOPMENT OF COST-BASED INDUSTRY NORMS

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About the Authors

Mr. Jay C. Smith is president of Public Knowledge, Inc., a professional firm in Portland, Oregon providing financial analysis and operations consulting services. Over the past ten years, Mr. Smith has assisted over fifty local franchise authorities with financial aspects of cable television regulation, including franchising, renewal, rate regulation, and ownership transfer proceedings. He has frequently served as an expert witness on issues relating to the economics of local cable system operations. Mr. Smith has also consulted to electric and other utility organizations on rate setting and cost allocation matters. He holds an undergraduate degree in economics and business administration and two interdisciplinary masters degrees from the University of Illinois. He has been a professional management consultant for 17 years, and is a Certified Management Consultant.

Mr. Michael Katz is the principal of KFA Services, an Edmonds, Washington firm providing financial, accounting, and economic analysis services to private and public sector clients. He frequently assists franchising authorities with cable television financial issues, and has served as an expert witness in cases involving cable system or other business economic matters. Mr. Katz has also developed cost finding and rate setting methods in other industries, including nursing homes, municipal utilities, the aerospace industry, and others. He holds an undergraduate degree in mathematics from the Massachusetts Institute of Technology (MIT), a masters degree in mathematics from Columbia University, and a masters degree in business management from MIT. Mr. Katz has been a professional management consultant for 19 years and is a Certified Management Consultant.

During the course of their work involving cable television, Mr. Katz and Mr. Smith have reviewed financial statements and financial projections for numerous local systems. They have also developed and applied cost analysis and revenue requirements models similar to the approach suggested in these comments.

Summary of Report

This paper comments on each of the possible rate regulation approaches identified by the Federal Communications Commission (Commission) to implement sections of the Cable Television Consumer Protection Act of 1992 (Act). It suggests that the same approach should be applied to both basic tier services and "cable programming services" (expanded basic tier).

Our fundamental position is that a cost-based approach is required if the monopoly component of rates is to be reduced. The approach can be simplified by choosing certain significant norms; that is, benchmark costs may be applied.

The summary advantages and disadvantages of the regulatory methods identified by the Commission are as follows:

- Using a benchmark of the rates charged by systems with effective competition could potentially produce reasonable rates, but there is unlikely to be a sufficient sample of such systems. Cost information, as well as rate information, will also be needed. Nevertheless, we believe that rate data for these systems can be useful as evidence of the size of the monopoly component in current rates, particularly if the results are checked by examining municipally owned systems.

- Applying 1986 rates, with an adjustment factor, could lead to lower rates, but this approach presents several problems. The difficulties include the facts that the base 1986 rates may not have been reasonable, and problems arise in doing comparisons when there has been widespread re-tiering since 1986. Reconstructing the history of particular systems since 1986 could be difficult. Simpler averaging approaches may be insensitive to certain local cost factors that are enumerated in the Act as criteria for consideration.

- As the Commission recognizes, a benchmark based on the current average rates would not achieve the most important Congressional objective, achieving rates that are no higher than if there were effective competition. There would be several issues regarding possible comparability distortions if such an approach were implemented.

- The Commission suggests a cost-of-service benchmark approach, which is similar to the approach we recommend. Our recommended approach varies slightly from that described by the Commission in that we would allow the possibility of combining certain local specific information along with national norms to achieve the benchmark result for each community.

- Price caps could be a relatively uncomplicated approach to adjust rates once they have been reasonably set, but cannot be used to establish the initial regulated rates. The cost-of-service

benchmark model we propose could be an effective way for the Commission to determine the annual price cap index, fairly reflecting the actual cost factors in the industry.

- Applying the direct cost of signals plus a nominal contribution to joint and common costs could produce low rates for the lowest basic service tier, and potentially could be administratively simple. In fact, in many systems there may be no truly direct programming or other direct costs on the lowest tier. However, possible undesirable re-tiering incentives could result from this approach.

- A system-specific utility cost-of-service approach could produce fair rate results, but could be difficult to administer if it were the primary method for all franchise areas. We believe that it should be preserved for those local franchise authorities who wish to apply it. If it is to be used on appeals to the Commission, however, we believe that franchising authorities as well as cable operators should be able to bring them. There are also several cost-of-service issues on which we believe the Commission should take a position, whether a system-specific utility approach or a cost-of-service benchmark is applied; these include:

  - Possible distortions resulting from related-party transactions should be corrected in the rate-setting process.

  - Intangible franchise value should not be allowed in the rate base, because to do so would guarantee returns above competitive levels, contradicting the intent of Congress.

  - Write-ups of tangible assets resulting from system sales should be disallowed in the rate base.

  - Capital and operating expenditures should be allowed only if prudent.

In an appendix to our report, we propose a cost-of-service benchmark model to assist franchising authorities and the Commission to regulate cable television rates, consistent with the requirements of the Act. The model can be applied using primarily certain national normative data on cable television system costs, or can be combined with inputs specific to a local franchise area. It calculates a rate ceiling for both basic and expanded basic service tiers. It addresses each of the factors that Congress and the Commission specified for consideration. We believe that the model has the following benefits:

- Assures that basic service and expanded basic rates are reasonable, protecting subscribers of any system not subject to effective competition from paying rates higher than those that would be charged if the system were subject to effective competition.

- Applies consistent procedures to basic and expanded basic tiers.

- Requires only information that is readily obtainable.

- Is based on a simple spreadsheet or tables that may be distributed to local franchising authorities to ease administrative burdens for both local authorities and the Commission.

- Provides appropriate incentives for cost control by applying normative costs.

- Reflects the key relevant factors.

- May be used as the method to determine annual price cap changes.

An explanation of the suggested model is included in the appendix.

A second appendix reviews the evidence of the monopoly status of local cable television systems. It concludes that there is ample reason to believe that basic and expanded basic rates should be significantly lower than they are currently in most systems if the "competitive rates" objective of the Act is to be achieved. For example, we believe that the $10 to $11 rate certain operators are now announcing for a stripped down basic tier of service will be at least twice as high in most systems as it should be if it were cost based.

REPORT TO THE FEDERAL COMMUNICATIONS COMMISSION IN RESPONSE TO NOTICE OF PROPOSED RULEMAKING TO IMPLEMENT RATE REGULATION SECTIONS OF THE CABLE TELEVISION CONSUMER PROTECTION ACT OF 1992

1. Introduction

The Federal Communications Commission (Commission) seeks comments on rate regulation approaches to implement sections of the Cable Television Consumer Protection Act of 1992 (Act).[1] The Notice of Proposed Rulemaking (NPRM) identifies objectives of the Act and factors cited in the Act that the proposed rate regulation method should address.[2] The Commission proposes two broad approaches, benchmarking and cost-based, and expresses a preference for a benchmarking approach.[3] The Act requires that the regulatory method should assure that basic service tier rates are reasonable, protecting subscribers of any cable system not subject to effective competition from paying rates higher than those that would be charged if the system were subject to effective competition.[4] The method should also seek to limit the administrative burden on subscribers, cable operators, franchising authorities, and the Commission.[5]

To achieve these objectives for the basic service tier, the Act directs the Commission to consider certain factors:[6]

- The rates for cable systems that are subject to effective competition
- The direct costs of obtaining, transmitting, and providing basic tier programming
- Only a reasonable and properly allocable share of joint and common costs
- Revenue from advertising or other consideration in connection with the basic tier

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[1] FCC 92-544. Notice of Proposed Rulemaking (NPRM) adopted December 10, 1992; released December 24, 1992. MM Docket 92-266.

[2] NPRM para. 30 for the basic service tier; para. 90 for "cable programming services."

[3] NPRM para. 33 for the basic service tier; para. 92 for "cable programming services."

[4] Communications Act, Section 623 (b) (1), 47 U.S.C. Section 543 (b) (1). NPRM para. 30.

[5] Communications Act, Section 623 (b) (2) (A) and (B), 47 U.S.C. Section 543 (b) (2) (A) and (B). NPRM para. 30.

[6] NPRM para. 30.

- The reasonable and properly allocable portion of taxes and fees imposed by any state or local authority
- The cost of satisfying franchise requirements to support public, educational, and access (PEG) channels
- A reasonable profit, consistent with the goal of protecting subscribers in any cable system not subject to effective competition from paying more for the basic tier than subscribers would pay if the system were subject to effective competition.

The factors to be considered for "cable programming services" (expanded basic tiers) rates are similar.[7]

- Rates for similarly situated systems taking into account similarities in costs and other relevant factors
- Rates of systems subject to effective competition
- The history of rates for the system including their relationship to changes in general consumer prices
- The system's rates as a whole for all services other than programming provided on a per channel or per program basis
- Capital and operating costs of the system
- Revenue from advertising or other considerations associated with the services.

The objectives of the Act and the factors it specifies to consider are sufficiently similar for the basic service tier and "cable programming services" (expanded basic tier), that we believe the same method for determining reasonable rates should be applied to each category.[8] We therefore agree with the Commission's tentative conclusion that the advantages and disadvantages of the various alternatives the Commission discusses in the NPRM for the basic tier are equally applicable to the expanded basic tier (or tiers).[9]

Consequently, we present an integrated set of comments on the methods the Commission has specified, covering both basic and expanded basic service tiers.[10] These methods include:

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[7] NPRM para. 90.

[8] We will use the term "expanded basic" tier to mean service tiers (other than per channel or per program pay services) for which the subscriber must pay a fee higher than that paid for the lowest tier.

[9] NPRM para. 92.

[10] Methods discussed in NPRM paras. 34 through 61. The Commission believes that each of these methods, with the exception of "direct cost of signals/nominal contribution to joint and

Benchmark alternatives
- Rates charged by systems facing effective competition
- Past regulated rates
- Average rates of cable systems
- Cost-of-service benchmark
- Price caps

Individual system cost-based alternatives
- Direct cost of signals plus nominal contribution to joint and common costs
- Cost of service

2. Rates Charged by Systems Facing Effective Competition[11]

Presuming there were a sufficiently large number of such systems and that the data were effectively collected and applied, this method would appear to meet two of the key objectives of the Act: it would help assure that subscribers where there is no effective competition pay rates no higher than where there is, and the method would not be unduly administratively burdensome. Therefore, we encourage the Commission to collect data from systems in communities where there is effective competition to help provide a basis for regulating rates in areas where there is not.

We suggest that the Commission collect actual cost information from these and other systems, as well as rate information. By this we mean cost information derived from system accounting records, not just information regarding factors that influence cost (such as plant mileage, the number of subscribers, etc.). This will enable the Commission to assess the relationship between costs, rates, and the driving factors for these systems to better understand how the information may be fairly applied as a benchmark for other communities. The cost information for these systems could be applied as an important part of the data base to develop cost norms for another approach that we recommend. For instance, presumably there are incentives for operators to both be efficient and provide good service in communities where there is effective competition, so the cost information would be less likely to be either overstated (including imprudent expenditures) or understated (reflecting inferior service). Another reason for examining the cost information is that the cost data for these systems are likely to be more stable than the rate data, as rates may change frequently in competitive marketing strategies.

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common costs," could be applicable to expanded basic as well as to low basic tiers (NPRM para. 92).

[11] NPRM paras. 41 through 43.

The principal disadvantage of an approach based solely on competitive system rates is that there is unlikely to be a sufficiently large and diverse group of such systems, at least for the next several years, to make it feasible for this data base alone to be reasonably applied to cover all systems. Competition between cable systems is rare and tends to be unstable, and frequently systems that once competed become merged or one operator ceases business. Price competition may not occur if one operator is in the process of selling to the other, or if an operator serves a large, non-competitive area and the competitive area is limited. Indeed, the rarity of effective competition appears to be one of the key reasons for the Act, and the instability of the competition is itself evidence of the monopoly characteristics of the industry.[12]

One way to increase the amount of data for "effective competition" areas is to include areas if the franchising authority itself "offers video programming to at least 50 percent of the households in that franchise area," regardless of whether actual competition exists.[13] There appear to be at least 60 or more jurisdictions where this is the case.[14] However, we caution that a municipal system could price based on costs and a return to recover its investments, or by setting rates so that they are comparable to rates charged by private systems.[15] We suggest that the Commission include these jurisdictions in its data collection efforts for effective competition areas. The Commission should collect and analyze cost data as well as rate data for these jurisdictions. An understanding of the cost information for municipally owned systems will help the Commission to determine what adjustments, if any, should be made for operating cost, tax, and cost of capital factors to make the municipal data comparable to information for privately owned systems.

In addition, we believe that an average rate per channel approach would lead to unduly high rates for systems with high channel capacity on the basic tiers, because there is unlikely to be a large group of high channel capacity competitive systems in the near term. There are economies of scope in cable operations, so that total costs generally do not increase in proportion to increases in channel capacity. Extrapolating rates per channel from smaller systems to a larger system would not capture these economies. That is, the cost per channel typically declines as channel capacity increases.

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[12] This issue is discussed further in Appendix B.

[13] NPRM para. 7. Communications Act, Section 623 (1) (1) (B), (C); 47 U.S.C. Section 543 (1) (1) (B), (C).

[14] "Municipally Owned Cable Television Systems," Public Power, January-February, 1993, pp. 156 - 159. There are also many co-operative or non-profit systems that could add further to the data base.

[15] A few of these systems are in fact in competition with privately owned systems.

The Commission has already initiated a survey to obtain rate data for effective competition areas, among others. In spite of our caveats and concerns, we suggest that the Commission analyze the "effective competition" sample results as preliminary evidence of the size of the monopoly component in cable rates where there is no competition. (See Appendix B). Over the long term, the Commission should collect cost data, not just rate information, from a broad cross section of cable systems, including those involved in competition.

3. Past Regulated Rates[16]

The Commission considers developing a benchmark based on rates charged in 1986. This approach would assume that rates in 1986 were reasonable because basic rate regulation of most cable systems was permitted at that time, and various factors would be applied to adjust these rates to the current period. The Commission apparently contemplates a system-by-system approach, where certain system-specific data (for example, rebuild or construction costs) would be applied, although it also seeks comment on whether average rates might be used as the benchmark.

Although this approach would likely lead to lower rates than if current average rates are used as the benchmark, we see several problems in attempting to implement it. First, it is not correct to assume that merely because most franchising bodies had the legal authority to regulate basic rates through 1986 that they exercised it. In fact, only a small minority of local jurisdictions assessed the fairness of cable television rates, and thus there is no assurance that overall 1986 rates bore a reasonable relationship to costs at that time. In addition, it may be difficult to extrapolate 1986 rates forward to the present. Many systems, if not most, have re-tiered or otherwise changed their channel line-ups since 1986, so there would be comparability issues. Using a per channel approach could lead to distorted results. Rates on a per channel basis for old, 12-channel systems are often higher than for larger systems. This reflects the fact that there are economies of scope in cable operations, so that total costs do not generally increase in proportion to increases in channels. Further, operators can reduce costs by moving more expensive services off the system, or to higher tiers. For instance, how would one treat a system that offered 20 basic services, including all of the most popular basic programming, on the lowest cost tier in 1986, but today has moved all of the most popular cable programming to a higher tier, even though there still may be 20 channels of broadcast, PEG, educational, and less popular programming on the lowest cost tier?

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[16] NPRM paras. 44 and 45.

4. Average Rates of Cable Systems[17]

Although potentially not administratively burdensome, this alternative cannot result in establishment of reasonable rates. The Commission rightly concludes that the use of current average data, unadjusted, "would not reflect competition but merely average performance in the industry; if monopoly profits were reflected in the rates of at least some industry segments, they would be incorporated in the average rate."[18] Thus the use of current average rates would likely violate the intent of Congress, who declared for example, that there is "...undue market power for the cable operator as compared to that of consumers and video programmers."[19]

However, we do encourage the Commission to regularly collect and analyze data on current rates, and to obtain and assess cost data as well so that a systematic consideration of the relationship among costs, rates, and other factors may inform Commission and local franchise authority proceedings on cable rate matters. We caution again that it is not a simple matter to express rates in a manner that is comparable across systems. In addition to the "per channel" and program line-up variation difficulties already noted, there are currently many variations among systems in how installations, additional outlets, and converters or remote controls are priced and either factored in or not factored in to the monthly charges. The treatment of franchise fees and other local cost factors also varies notably across systems. While some of these problems may be mitigated by new Commission rules, they would be inherent in any 1992 or 1993 data that the Commission might attempt to use as a starting point.

5. Cost-of-Service Benchmark[20]

Under this approach the Commission would use certain data to construct the costs of an "ideal" or "typical" cable system or systems. The Commission contemplates a national benchmark or several benchmarks representing groups of identifiable system characteristics.

This approach comes the closest to the one we recommend. One of its advantages is that it would base rates on costs, which we believe is the best approach to help assure that the rates cover reasonable and prudent costs, but do not significantly exceed costs, including a fair return

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[17] NPRM paras. 46 and 47.

[18] NPRM para. 47.

[19] Senate Conference Report on the Act, Section 2 (a) (3).

[20] NPRM para. 48.